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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973.

No. 73-720

EDWARD WARNER AND ELIZABETH WARNER,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

REPLY BRIEF.

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Although counsel for the petitioners[1] received no copy of any Order of this Court extending the period provided by Rule 24 of the Rules of the Supreme Court for the filing of a Brief in Opposition, the respondent filed herein on January 9, 1974, more than two weeks after the expiration of the period provided by Rule 24, a "Memorandum for the Respondent in Opposition." The petitioners had filed their Petition for Writ of Certiorari with this Court on October 31, 1973. In his Memorandum, the respondent has woefully misstated both a determinative factual conclusion reached by the Court of Appeals and a most significant element of its Order which reversed the key finding of fact upon which the adverse Tax Court

1. All references to "petitioner" are to Edward Warner, since his wife is a party only by virtue of having filed a joint federal income tax return with Mr. Warner for 1965.

decision was based. Because of such serious misstatements, the filing of this Reply Brief to rebut such misstatements has been made necessary.

In addition, the filing of this Reply Brief has also been necessitated by the Internal Revenue Service having issued after the date of the filing of the Petition herein Rev. Rul. 74-8, I. R. B. 1974-1, 16, which has significantly modified and liberalized Rev. Rul. 58-557, 1958-2 C. B. 402, and Rev. Rul. 63-221, 1963-2 C. B. 332, which are cited in such Petition. For reasons hereinafter discussed, Rev. Rul. 74-8 further underpins the petitioners' position that they are entitled to the nonrecognition treatment provided by Section 1033.

More specifically, in support of his contention that "petitioner could not reasonably have believed that his land was under threat or imminence of condemnation when it was sold in 1965" (Memo. p. 2), the respondent relied almost exclusively upon the following misstatements of the factual situation:

> 1. "T. R. Tucker . . . told petitioner that the state . . . had funding problems with the park project that definitely precluded the possibility of condemnation (Pet. App. A2-A3, A9-A10)." (Memo. p. 2);
>
> 2. "Petitioner's admission that Tucker said he was not going to condemn petitioner's property. . . ." (Memo. p. 3);
>
> 3. "Tucker's undisputed statement that he would not condemn the property." (Memo, p. 3, n. 2.)

The respondent then set forth this distorted and wholly erroneous interpretation of the holding of the Court of Appeals:

> "It held, however, that petitioner's admission that Tucker said he was not going to condemn petitioner's property was 'more than sufficient' to support the Tax Court's ultimate finding (Pet. App. A3-A4).[2] The affirmance of the Tax Court upon this alternative basis does not, as petitioner argues (Pet. 15-16), represent an erosion of

the Tax Court's decision. It simply reenforces the Tax Court's ultimate finding with additional record evidence." (Memo. p. 3.)

From the foregoing, it is apparent that the respondent failed to comprehend that the Court of Appeals held that the Tax Court's key finding of fact, that Mr. Tucker had told petitioner Edward Warner that condemnation by the state was definitely precluded, was not supported by the record, and thus was erroneous. (Pet. App. A2-A3) The Court of Appeals' holding on this point is clearly and unequivocally stated as follows:

> "The Warners argue that the Tax Court clearly erred in finding that Tucker had told them that condemnation by the State would not occur. In support of its holding, the Tax Court placed prime reliance on the following testimony from Tucker:
>
> Q. Was condemnation mentioned in your negotiations with Mr. Warner?
>
> A. At any time?
>
> Q. Yes.
>
> A. Yes, the subject was brought up by Mr. Warner. We find clients always have an interest in what our inherent powers are and the extreme reluctance of the Department of Conservation and the limited history of condemnation is always brought to the fore at this point. In my twenty-five years with this division it had less than four cases. This is always brought out, and the funding difficulties and situations and limitations on our ability to proceed definitely precluded any possibility of condemnation.
>
> *We must agree that this statement fails to support the findings of the Tax Court.* The Government cites additional testimony of Tucker to the effect that he informed the Warners of funding difficulties in connection with the proposed park, but it cannot seriously be contended that statements of this sort bear more than remotely on the possibility that Tucker discussed his inability to condemn with the Warners. (Pet. App. A2-A3) (Emphasis added.)

That such finding of fact was found to be erroneous cannot be seriously disputed. Thus, since the respondent's arguments in opposition to the granting of the instant Petition for Writ of Certiorari are based entirely upon that finding of fact which was the keystone of the Tax Court decision, but which was found to be erroneous by the Court of Appeals, those arguments must fail.

A great deal of significance should be attributed by this Court to the fact that the respondent did not contest in its Memorandum the petitioners' contention that the Court of Appeals' reversal of that key finding of fact required the reversal of the Tax Court's adverse decision. Rather, the respondent misstated the Court of Appeals' holding on this key finding of fact in order to avoid having to attempt to rebut such contention. The respondent's failure to address himself to this contention should be construed by this Court as an admission that the reversal of this key finding of fact required the reversal of the Tax Court's decision, and that the Court of Appeals' failure to so reverse such decision was erroneous and should be corrected by this Court.

Also in his Memorandum, the respondent characterized as a "factual determination" the conclusion of both Courts below that a threat or imminence of condemnation was not present when the petitioner sold his property. (Memo. p. 1) This, of course, overlooks the fact that such holdings involve the application of provisions of Section 1033 of the Internal Revenue Code of 1954, as amended, to the factual situation as found to exist by the Tax Court, and as corrected by the Court of Appeals. This causes such holdings to constitute the resolution of a question of law, or at the very least, a mixed question of law and fact. As such, those holdings are subject to review free of the restraints of the "clearly erroneous" rule. *Simpson* v. *United States,* 261 F. 2d 497 (7th Cir. 1958); *Chandler* v. *United States,* 226 F. 2d 403 (7th Cir. 1955). Respondent also incorrectly inferred that the petitioner's sale of his property to a third party, Gerald Derks, an agent of Consumer's

Power Company, prevented such sale from having been made pursuant to a threat or imminence of condemnation emanating from T. R. Tucker of the Michigan Department of Conservation. This completely overlooks the fact that the nonrecognition treatment provided by Section 1033 is extended to a taxpayer who is under a threat of imminence of condemnation even though he sells his property to a party other than the one who has created such threat or imminence of condemnation, *S. & B. Realty Co.*, 54 T. C. 863, *acq.* 1970-2 C. B. xxi (1970); *S. H. Kress & Co.*, 40 T. C. 142 (1963).

Of equal importance to the foregoing is the Internal Revenue Service's issuance of Rev. Rul. 74-8, I. R. B. 1974-1, 16, which modified and liberalized Rev. Rul. 58-557 and Rev. Rul. 63-221, both of which are cited in the Petition. Rev. Rul. 74-8 interpreted those two Rev. Ruls. as holding that

> "generally, the threat or imminence of condemnation is considered to exist for purposes of section 1033 of the Code when the property owner is informed, either orally or in writing by a representative of a governmental body or public official authorized to acquire property for public use, that such body or official has decided to acquire his property, and from the information conveyed to him has reasonable grounds to believe that his property will be condemned if a voluntary sale is not arranged."

However, Rev. Rul. 74-8 then greatly liberalized the standard for determining the existence of a threat or imminence of condemnation by holding that where a public utility had not yet obtained the power under state law to condemn property at the time that the taxpayer entered into an agreement to sell his property, the remainder of the factual situation nonetheless made it reasonable for the taxpayer to conclude that his property was subject to a threat or imminence of condemnation, and the nonrecognition provisions of section 1033 were extended to such sale. That Rev. Rul. states:

> "Since there were no reasonable grounds to believe the utility might not obtain the power to condemn the prop-

> erty, the sale was made under threat or imminence of condemnation, notwithstanding that the utility did not yet have the legal power to condemn."

Thus, Rev. Rul. 74-8 evidences a significant shift in emphasis by the Internal Revenue Service. Rather than requiring a showing of reasonable grounds to believe that the utility either had or would obtain the power to condemn as a pre-requisite for nonrecognition treatment under section 1033, the Internal Revenue Service merely established as the standard the negation of reasonable grounds to believe that the utility might *not* obtain the power to condemn.

Applying the holding of Rev. Rul. 74-8 by analogy to the instant case, it is undisputed that the Michigan Department of Conservation did in fact possess the power of condemnation, and the Tax Court's findings of fact, as corrected by the Court of Appeals, established that T. R. Tucker, an official with that Department, did in fact discuss that Department's condemnation powers with Mr. Warner, and did *not* advise him that his property would not be condemned if a voluntary sale was not arranged. In view of the remainder of the factual situation, which is detailed at pages 22 through 27 of the Petition, not only were there no reasonable grounds to believe that the petitioner's property would not be condemned if a voluntary sale were not arranged, but there were in fact reasonable grounds for believing that his property would be condemned if a voluntary sale were not arranged.

In summary, then, Rev. Rul. 74-8 found a threat or imminence of condemnation to be present despite that the "condemning authority" did not in fact have the power of condemnation at the time of the sale of the real estate in question, whereas the Court of Appeals did not find a threat or imminence of condemnation to be present in the instant case, despite the totality of the factual situation, simply because the petitioner was advised that the state "could" condemn his property, rather than that the state "would" condemn his property, in the event

that a voluntary sale were not arranged. This highlights the difference between the standard applied in Rev. Rul. 74-8 and that applied by the Court of Appeals in the instant case to determine the existence of a threat or imminence of condemnation and, in view of the grave financial injury which will otherwise be imposed upon the petitioners, it underscores the need for this Court to grant certiorari to cure the serious error committed by the Court of Appeals and to provide consistency in the application of the provisions of Section 1033 to the petitioners and other taxpayers similarly situated.

CONCLUSION.

For the reasons set forth above, and for the reasons previously set forth in the Petition, the petitioners respectfully renew their prayer that a Writ of Certiorari be granted to review the Order of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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